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SUMMARY OF ARGUMENT.

I.

Section 77 of the Bankruptcy Act effects a fundamental change in reorganization procedure of railway corporations and in the jurisdiction of the bankruptcy courts.

The basic principle of a bankruptcy statute is that the property of the bankrupt should be liquidated, and the proceeds distributed among the creditors. Section 77, in providing for a reorganization plan for railroads, either insolvent or unable to meet their obligations, is not essentially a bankruptcy act, but a reorganization statute, since the roads must be kept in operation and the paramount interest of the public service must be preserved.

The section was adopted in order to remove many objections to the equity procedure of reorganization through the form of foreclosure and sale. Its principal incentive was to give to the Interstate Commerce Commission jurisdiction over the reorganization plan, and the consequent power to deal with the claims and interests of all creditors. This was in accord with the policy adopted in 1920 of giving the Commission jurisdiction over all security issues. Section 77 was added to the Bankruptcy Act, rather than to some other statute, because of the desire to utilize the machinery and procedure of the bankruptcy courts.

Detailed consideration of Section 77 shows that it applies to all creditors, secured and unsecured. For the first time in the history of bankruptcy legislation Congress has attempted to deal with the rights of secured creditors. Creditors are so defined in the act as to make it clear that

they can be dealt with only through the plan of reorganization, which plan is the sole end and aim of the act.

The plan contemplated by the statute deals with all the property of the debtor corporation and its subsidiaries. The court has no power to deal with the property, except the power to "operate the business." The determination and disposition of all interests in the property is a function vested exclusively in the Interstate Commerce Commission through the reorganization plan.

The legislative history of Section 77 makes it clear that it was the purpose to require all creditors, secured or unsecured, to be dealt with by the Commission in its consideration of the plan of reorganization; that in all such matters the judgment and decision of the Interstate Commerce Commission must prevail. The effect, therefore, of the filing of the petition for a reorganization, and its approval by the court as being properly filed, is immediately to fix a status for all creditors of the trust estate, which can be altered only by appropriate proceedings in the formation, consideration and adoption of a plan of reorganization, in the manner prescribed in the Act.

II.

A discussion of the points made by petitioners.

i. Section 67(d) of the old bankruptcy act, providing that liens given and accepted in good faith shall not be affected by proceedings under the old act, is not involved in the case, because the injunction to restrain the sale of the pledged collateral does not interfere with the lien of the pledgees. These pledgees will come into a reorganization plan with the status of secured creditors, and must be

dealt with accordingly. Any other construction of Section 67(d) would be inconsistent with Section 77(n), which makes the old act applicable only so far as consistent with the provisions of Section 77.

Likewise, the provisions of Section 57(h) of the old act, which provide that the value of securities held by secured creditors shall be determined by converting the same into money, by agreement, arbitration, compromise, or litigation, as the court may direct, is inconsistent with Section 77(n). Under Section 77, the determination of value of the securities and their disposition is within the exclusive province of the plan of reorganization. No creditor has a right to anticipate the plan of reorganization and the Commission's exercise of its statutory jurisdiction thereon by converting his collateral into money or otherwise disposing of it. The provision making secured creditors amenable to the reorganization plan was inserted into the act deliberately, as is shown by quoted debates in Congress, and there is no room for doubt as to its interpretation.

ii. No support for petitioners' position is to be derived from Section 77(l). Their argument is that, since that section authorizes the court to stay the sale of collateral pending suits, and to enjoin or stay the commencement or continuance of judicial proceedings to enforce liens, and fails to confer power to restrain the sale of collateral by a pledgee, the right of the pledgee to make such sale must be recognized. The court's power to enjoin the sale of collateral rests in Paragraph 15 of Section 2 of the Act. For the purposes of proceedings under Section 77, the jurisdiction of the court below extends to wherever the property of the debtor may be located.

iii. The interest of the debtor, that is, the trust estate, in this pledged collateral constitutes property. Title to it is in the Trustees in Bankruptcy. The court has exclusive jurisdiction of such property, wherever located. It may protect that jurisdiction by an injunction.

iv. The injunction was fully justified by the facts. A sale of the collateral held by the petitioners would increase the obligations of the trust estate, which must be dealt with in the reorganization plan, by some $40,000,000. The trust estate has other collateral pledged under various indentures now in default; if this also should be sold, the obligations of the trust estate would be increased by some $200,000,000; any such sale would amount to an anticipation of the plan of reorganization and an invasion of the jurisdiction of the Interstate Commerce Commission.

v. Sundry minor objections presented by petitioners are discussed.

ARGUMENT.

Only one question is presented in this case,—whether in proceedings in the District Court for the reorganization of a railroad under Section 77 of the Banruptcy Act, and pending the preparation and submission to the Interstate Commerce Commission and to the Court of the plan of reorganization contemplated by that section, the Court may restrain secured creditors from disposing of their collateral.

I.

Section 77 of the Bankruptcy Act effects a fundamental change in reorganization procedure and in the jurisdiction of the bankruptcy courts.

i.

The general purpose of the section.

As a first step in the consideration of the issue stated above, we must call the attention of the Court to the fundamental change in the law represented by Section 77; not only as those changes affect the rights of creditors, secured or unsecured, and of the corporations themselves, but of the public. This fundamental change has entailed, as a corollary, and as a matter of necessity, equally important changes in the jurisdiction and procedure of the Federal District Courts.

The Bankruptcy Act, as it stood prior to the enactment of Section 77, was the growth of a century or more of legislation and judicial decision. Its basic theory was that the

business or property of a bankrupt should be liquidated and distributed among the bankrupt's creditors. That done, the bankrupt was discharged. Congress did not exercise until the year 1800 its power to establish uniform laws on the subject of bankruptcies. Since the first statute was passed, the field has been extended to include persons not subject to the original law, voluntary petitions have been sanctioned, and composition agreements have been authorized. But, until the present statute, no bankruptcy act, so-called, included a railroad corporation.

Prior to Section 77, the only method of reorganizing a railroad corporation was through an equity receivership. Many criticisms have been made of these proceedings, and there were certain features in the conduct of the proceedings, such as the necessity for ancillary receiverships, which were troublesome and expensive. The equity receivership usually went through the form, and the form only, of foreclosure and sale. Only one court, so far as we know, had had the courage to look through the form and act upon the substance; thereby anticipating Section 77 by some sixteen years (*Phipps* v. *Chicago, R. I. & P. Ry. Co.*, 284 Fed. 945; C. C. A. 8th, 1922).

Railroad corporations cannot be liquidated; the railroads must be kept in operation. The paramount necessity is the public service. As a part of that necessity, they must constantly have an inflow of new capital for the necessary additions and betterments involved in their ordinary operation, maintenance and replacements. Since, in a financial depression like the one which has existed now for more than five years, this new capital can no longer be obtained from earnings or from borrowing, the corporation must in some measure be relieved from the stress

of maturing interest obligations. The difficulty in providing this capital is illustrated in the statutes creating the Reconstruction Finance Corporation, and particularly in the provisions of those statutes that the Reconstruction Finance Corporation may make loans to aid in temporary financing of railroads *unable to obtain funds through banking channels or from the general public* (Appendix to R. F. C. Brief, p. 3).

Another most important consideration was the public interest in the reorganization plan. Under the equity procedure the approval of the plan was for the Court, although since 1920 the issuance of the necessary securities has been placed within the exclusive and plenary jurisdiction of the Interstate Commerce Commission (*Interstate Commerce Act, Section 20a*). This Act, however, gave the Commission no jurisdiction over the details of the plan, or the settling of controversies as to the rights of creditors, secured or unsecured. All these matters were within the jurisdiction of the courts.

Section 77 must be read with these facts in mind.

When one reads it, one is impressed by the thought that its source of power may be in the commerce clause, as well as in the bankruptcy clause. The point is not important; it can be justified under either. The important point is that the paramount purpose of the section was the public interest, which is dependent upon the transportation system of the country and is vitally concerned with the continuance and efficiency of the railroad systems. It deals categorically with the three parties in interest,—the public, the creditors, and the debtor corporation and its stockholders. From the moment the petition is approved by the District Court, the Act impounds the rights of all, so to speak, until the

reorganization plan is consummated, to the end that through a readjustment, modification, or alteration of the rights of the creditors, secured or unsecured, and of the stockholders, the capital structure and the physical properties of a financially embarrassed railway company may be so reorganized, under the supervision of the Interstate Commerce Commission, as to enable the corporation to continue to function and adequately to serve the public.

The genius of the section centers in the reorganization plan, which must be considered by the Interstate Commerce Commission representing the public at hearings at which every creditor and every stockholder has a right to present his views, and must be confirmed by the Court. Every provision of the section is designed to bring about the formulation and acceptance of a feasible plan, involving only the issuance of such securities as shall be approved by the Commission as compatible with the public interest; second, to subject the corporation, its creditors and its stockholders to the control of a court which is vested with plenary power to protect the rights of all, and to preserve the status and relativity of such rights while the plan is being formulated; and, third, to provide the legal machinery for making an accepted and approved plan effective and binding upon all concerned.

To this end, Congress added Section 77 to the Bankruptcy Act; not because the proceeding contemplated by Section 77 was primarily a bankruptcy proceeding, but because Congress desired to utilize so far as "*consistent*" the machinery and procedure which had been developed under that Act. It might just as well have been placed in the Interstate Commerce Act, except for the desire of Con-

gress to utilize the well-established bankruptcy procedure of the federal courts.

But the interpretation of Section 77 cannot be predicated upon cognate provisions of the Bankruptcy Act; for the purposes of the Acts are diametrically opposed to each other. A detailed consideration of Section 77 will lead to the conclusion that Congress intended that when the court makes an order approving a reorganization petition as having been properly filed, the effect of the order is immediately and *ipso facto* to subject the debtor and its properties, and the rights of its creditors and stockholders, to the jurisdiction of the court and of the Interstate Commerce Commission, to be dealt with by the court and the Commission exclusively, subject only to the written consent of the requisite number of each class of creditors and stockholders, in the formulation, approval and confirmation of a reorganization plan.

A corollary of the foregoing is that the ordinary course of business conduct that is open to creditors and stockholders, and the ordinary remedies that are available to them, are necessarily held in abeyance, by the force of the amendment, pending the formulation of a reorganization plan; for the pursuit of such course, or the enforcement of such remedies, might interfere with and even prevent the formulation of a complete, efficient, equitable and nondiscriminatory plan. In other words, the effect of the Court's order approving the filing of the petition is to fix a status for the entire trust estate and all of its property, wherever located, which can only be changed through the formulation of a plan of reorganization, and its approval by the Commission and the Court.

ii.

Certain details of Section 77.

First. Section 77 contemplates that creditors shall act by classes, and not each creditor for himself. Action by an individual creditor in the exercise of a contractual right, or in the pursuit of a legal remedy, is inconsistent with the power and right vested in the debtor corporation, the Trustees appointed by the Court, the creditors, the stockholders, and in the commission, to propose a plan of reorganization embodying a modification or alteration of the rights of creditors generally, secured or unsecured, or of any class of them, including the rights of such individual creditor.

Action by an individual creditor is also inconsistent with the formulation of a plan. According to the express terms of the act a reorganization plan must be equitable, must not discriminate unfairly in favor of any class of creditors or stockholders, must be financially advisable, and must be compatible with the public interest. A plan conforming to all of these requirements could never be formulated if each creditor is allowed to exact the full measure of his individual rights, without reference to the rights of other creditors, of the debtor, or of the public. The amendment, therefore, treats the rights of creditors as relative, not absolute. And while it authorizes a modification of such rights, the modification itself must preserve the relativity of those rights, must be equitable, must not discriminate unfairly in favor of any class of creditors, must be financially advisable, and must be compatible with the public interest. All these matters are entrusted primarily to the Interstate Commerce Commission, and *thereafter* to the approval of the Court.

The section authorizes a reorganization plan embracing all the creditors of the debtor corporation, except those specifically pretermitted from the plan, and for whom provision is otherwise made. It provides that the term "creditors" shall include, for *the purpose of a reorganization plan, its acceptance* and *confirmation,* "all holders of claims, interests, or securities, of whatever character against the debtor or its property." All creditors, therefore, including the holders of securities, must defer individual action for the realization of their rights, and await the formulation of a plan. If this were not so, creditors, by their own act, could eliminate themselves from the reorganization plan, and thus defeat the very purpose of the amendment. Moreover, a member of a class of creditors could thereby escape being bound by the action of two-thirds in amount of the creditors of his class in accepting a plan. And individual creditors could prevent any modification or alteration of their rights—the very thing which Section 77 contemplates and expressly authorizes.

It might be stated, in passing, that the Congress possesses the constitutional power to require a modification of the rights of creditors of interstate railroad corporations for the benefit of the general good, where the exertion of the power is necessary in order to enable such corporations, through a reorganization of their capital structures and physical properties, to continue to operate in interstate commerce, and to serve the public. The questions raised by the briefs of petitioners as to the constitutionality of Section 77 on the ground of its conflict with the Fifth amendment are, therefore, not of great weight. The principle has been stated by the Supreme Court as follows:

> "Under our form of government the use of property and the making of contracts are normally matters of private and not of public concern. The general rule is that both shall be free of governmental interferences. But neither property rights nor contract rights are absolute; for government cannot exist if the citizen may at will use his property to the detriment of his fellows, or exercise his freedom of contract to work them harm. Equally fundamental with the private right is that of the public to regulate it in the common interest."
>
> *Nebbia* v. *New York* (1934), 291 U. S. 502, 54 Sup. Ct., 505.

Second. The amendment provides that the plan of reorganization may deal with all or any part of the property of the debtor. The equity of the debtor in securities pledged by it as collateral for loans made to it is property of the debtor. As such property, the amendment authorizes its disposition to be provided for in the plan of reorganization, and the disposition proposed in the plan will be binding on all concerned if the plan is accepted, approved and confirmed. The pledgee, therefore, is impliedly prohibited by the amendment from selling the securities, and thereby depriving the debtor, the creditors, the stockholders and the commission of their statutory right to effect a disposition of them through the approval, acceptance and confirmation of a reorganization plan.

Section 77 does not confer power even on the court itself, much less on the holders of claims against the trust estate, to deal with the property constituting the trust estate. The only power the court has with respect to the property is either directly or through trustees, and sub-

ject to "the jurisdiction of the Commission, as provided by the Interstate Commerce Act as amended, . . . *to operate the business of the railroad corporation.*" The matter of dealing with the property, in the sense that it constitutes assets of the trust estate, is committed exclusively to the Interstate Commerce Commission, and the only power conferred on the court is that of confirming a reorganization plan, dealing with the debtor's property, approved by the commission and certified by it to the court, if it conforms to the requirements of subsection (g) of the amendment; or to refuse to confirm it if it does not conform to such requirements. The court is powerless to propose a plan of reorganization or to alter or amend a plan certified to it by the commission. And since Congress conferred exclusive power on the commission to deal with the property of the debtor through the consummation of a reorganization plan that will be binding on all concerned, it could not have intended to leave individual creditors or classes of creditors free to thwart the judgment of the commission, or to paralyze its action, by pursuing remedies and making a disposition of the property of the debtor wholly inconsistent with the purpose of the amendment, and contrary to the necessary implications of its positive terms. And the authority conferred on the court, which is indicative of the real province of the court, is the power to prevent through its orders and injunctive process any interference by creditors or others with the property and affairs of the debtor, pending the formulation, approval and confirmation of the plan.

Thus, subsection (a) provides that if the petition for a reorganization is approved by the court as having been properly filed, the court shall, "during the pendency of the

proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located." And subsection (l) provides:

> "In proceedings under this section *and consistent with the provisions thereof,* the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

The outstanding feature of Section 77 is that it confers the power of reorganizing embarrassed railroad corporations not on the courts, but on the Interstate Commerce Commission. By its express provisions the commission is constituted a *quasi* judicial tribunal, invested with the power, and charged with the duty and responsibility, of perfecting and effecting a reorganization plan embodying a modification of the rights of creditors and a disposition of the property of the debtor that shall be equitable, shall not unfairly discriminate in favor of any class of creditors, shall be financially advisable, and shall be compatible with the public interest; to the end that the debtor corporation may be enabled to continue to operate its railroad properties for the benefit of its creditors, its stockholders, and the dependent public. Creditors, secured and unsecured, are required by the amendment to submit their rights to the commission, to be adjusted and provided for in a reorganization plan. They are given a day in court before the commission, in public hearings to be held on the plan, and the only remedy afforded them by the amendment is the right

to object to the plan itself, which includes a disposition of their claims, and of the property of the debtor, and to oppose an acceptance of the plan by the class of creditors to which they belong.

Third. The legislative history of Section 77 confirms these views.

The interpretation which we have placed on Section 77 is strongly fortified by the changes which were made in some of its provisions during its passage through Congress.

1. Companion bills were introduced in the House and in the Senate. The first sentence of subsection (b) as it appeared in the bills as originally introduced, and in the bill that originally passed the House, read as follows:

"A plan of reorganization within the meaning of this section (1) may include a proposal to modify or alter the rights of creditors generally, or of any class of them" (H. R. 13958, 72d Congress, 2d Session).

In the bill that passed the Senate, which was afterwards concurred in by the House, the word "shall" was substituted for the word "may." (76 Cong. Rec., p. 2905).

The substitution of "shall" for "may" is significant. It was evidently the thought of Congress that in order to reorganize the embarrassed railroads of the country there would have to be a modification of the rights of creditors, and it was the intention of Congress that the proposal for such modification should be included in the plan of reorganization itself. The obvious purpose was to preserve the relationship between the various classes of creditors and stockholders, for all are vitally interested in the modification of their respective rights. And by requiring that

a proposal to modify such rights shall be included in the plan, Congress safeguarded the rights of all; for a plan of reorganization could not become binding on them unless it was accepted by two-thirds of each class of creditors and stockholders. Moreover, the public itself is interested in the modification of the rights of creditors and stockholders, and the mandatory requirement that such proposed modification shall be included in the plan of reorganization was a potent means of safeguarding the interest of the public, because the plan of reorganization, including the proposed modification, could not become effective without the approval of the Interstate Commerce Commission. This is entirely consonant with the interest which the Interstate Commerce Commission has always displayed in the relation between capital stock and funded debt, and its suggestions from time to time that the ratio of funded debt to stock should be reduced.

During the consideration of the measure in Congress, an even more important change was made in subsection (b), which now requires that the plan

> "shall include a proposal to modify or alter the rights of creditors generally, or of any class of them, *secured or unsecured*, either through the issuance of new securities of any character or otherwise."

As we point out below, this language, together with similar language in the cognate Sections, 74 and 77B, constitutes the first action by Congress which contemplates, through bankruptcy proceedings, any modification or alteration of the rights of *secured* creditors.

2. The term "creditors" was defined in the original bill as follows:

"The term 'creditors' shall include, for the purpose of a reorganization proceeding under this section, all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act" (H. R. 13958, 72d Congress, 2d Session).

This definition was changed to read as follows:

> "The term 'creditors' shall, except as otherwise specifically provided in this section, include, *for all purposes of this section and of the reorganization plan, its acceptance and confirmation,* all holders of claims, interests, or securities of whatever character against the debtor or its property, including claim for future rent, whether or not such claims, interests, or securities would otherwise constitute provable claims under this title" (Sec. 77(b)).

This was a radical change, and one which throws considerable light on the proper interpretation of Section 77. It evidenced the intent of Congress, conclusively manifested by other amendments to the statute, to transfer the handling and control of the whole reorganization scheme, with all of its details, including the modification of the rights of creditors and stockholders, and the disposition of the debtor's property, from the court to the Interstate Commerce Commission, leaving practically nothing of material importance for the court to do except to examine the plan accepted by the creditors and stockholders, and approved by the commission, and confirm it if it met the requirements of subsection (g); or to disapprove it, and file an opinion stating its reasons therefor, if it failed to meet such requirements. And it evidenced the further intent of Congress to bring all the creditors, secured and unsecured, into

the scope and binding effect of the reorganization plan, to tie their rights into the nexus of the plan, and to keep them there until the plan is accepted and confirmed.

Under the amendment, therefore, the relative rights of creditors become fixed, so to speak, by the filing of the reorganization petition, and the status of such rights as of the date of the filing of the petition must remain unchanged until a plan of reorganization, proposing a modification of such rights, is formulated. The fundamental theory of the amendment is that a modification of the rights of creditors is a matter which concerns all creditors and stockholders alike, and also the public, and should be dealt with by the concerted action of all in the formulation of a reorganization plan.

The language underscored above fixed the creditors' status for all purposes of the reorganization plan, its acceptance and confirmation. That status is fixed as of the time when the Court approves the filing of the petition. No creditor, however well secured, can wash his hands of the proceeding until his claim has been passed upon by the Interstate Commerce Commission.

3. The debates in Congress during the passage of the bill, as well as the specific amendments made to it, conclusively show that such was the intention of Congress. The debates may be referred to for that purpose.

Manhattan Properties v. *Irving Trust Company*,
291 U. S. 320, 54 Sup. Ct. 385 (1934).

In stating and answering the objections to the bill during its pendency in the House, Mr. Dyer of Missouri said:

"The obvious objection to this bill is that it is a reorganization by the Interstate Commerce Commission, which would control in every respect, and the interposition of the court is simply to give legality to the Interstate Commerce Commission action" (76 Cong. Rec., p. 2911).

Mr. Dyer's position was that all the details of the reorganization should be left to the Commission, which was composed of a body of experts intimately familiar with railroad problems, and not committed to the courts, which might or might not have any expert knowledge of such matters. He further contended that the rights of a single class of creditors would affect the rights of other classes of creditors and of the stockholders, and, therefore, should be provided for in a plan which embraced them all. He said:

"The bill does state that the petition may propose to modify or to alter the rights of creditors generally or of any class of them; but it is evident that if applied to a single class it would affect the rights of other classes and stockholders, except in the case of a very simple capital structure." *Id.*, 2911.

Mr. Rayburn of Texas:

"The bill provides that the commission shall take off of the court all of the burden of holding hearings on the proposed plan of reorganization, of recommending a plan to creditors and stockholders who would be affected, of authorizing the issuance of securities and making orders conforming to the Interstate Commerce Act, and of submitting to the court a complete record on which it could determine whether or not, in fairness and justice to all con-

cerned, a plan of reorganization acceptable to two-thirds of the creditors in amount for each class should be approved." *Id.*, 2917.

Mr. LaGuardia of New York:

> "The next thing we did in this bill which is innovation is to bring complete control, or, as the Solicitor General says, 'giving broad powers to the Interstate Commerce Commission in the initiation, formulation, and approval of the reorganization plan.' We did just that." • • •
>
> "The purpose of this bill is to make that approval effective. It is to make that approval what it is intended it should be, a complete supervision and control of every detail and factor of a reorganization plan." *Id.*, 2923.

During the further discussion of the bill, Mr. LaGuardia said:

> "It is to overcome such a condition that we have written into this bill, as I said before, the powers of initiation, formulation and approval of the plan, and outlined the procedure in such a way as to make it clear that the judgment and decision of the Interstate Commerce Commission must prevail. • • •
>
> "The purpose of the bill is to convey such broad statutory powers to the commission as to give it, from the very beginning to the end, complete supervision and control and decision of railroad reorganization. • • •
>
> "The plan now goes to the court for final approval, but this approval is on the record of the case as submitted by the commission to the court. The court cannot commence hearings *de novo*, it cannot modify the plan, it cannot substitute its plan for one approved by the commission." *Id.*, 2924.

In discussing the bill in the Senate, Mr. Hastings said:

> "As the House considered it in committee and passed it they practically passed the power away from the federal courts into the Interstate Commerce Commission, leaving almost nothing for the courts to do except to approve of that which had been done by the Interstate Commerce Commission." *Id.*, 5106.

Mr. Hastings further said:

> "The Interstate Commerce Commission are familiar with the railroads. They know all the phases of the railroad problems. They could help the railroads to arrange a plan. They would send out notices to every creditor and to all the stockholders. They would all have an opportunity to come before the commission and be heard. If they agree on a plan which the Interstate Commerce Commission finds equitable and that it ought to be accepted, then it is submitted to the creditors of the corporation." *Id.*, 5108.

Mr. Robinson of Arkansas:

> "Reference has been made to the fact that the Interstate Commerce Commission is a tribunal intrusted with the regulation of railways engaged in interstate commerce. I point out to my good friend the Senator from Georgia (Mr. George) who criticized the amendment and who objected to it, that no reorganization can occur under the bill without the express approval of the Interstate Commerce Commission. So that we will have the advantage of the advice, the recommendation and decision of the Interstate Commerce Commission respecting almost every important step which it is necessary to take in connection with the reorganization of a railroad." *Id.*, 5128.

It must constantly be borne in mind that the sole purpose of the amendment is to bring about a reorganization plan, a readjustment of the capital structure, that shall be consented to by the creditors and stockholders of the debtor railroad company, and shall have the approval of the Interstate Commerce Commission and of the court. The amendment obviously contemplates that all matters which vitally affect the affairs of the debtor corporation, including the rights of its creditors and the disposition of its properties, shall be provided for and incorporated in the reorganization plan as a part and parcel of the plan itself. Any other construction would defeat or at least might jeopardize the accomplishment of the purpose of the amendment. And since Congress provided that the disposition of all these matters should require the consent of every class of creditors and stockholders, the approval of the Commission, and the approval and confirmation of the court, it could not have intended that individual creditors, or a class of creditors, should be at liberty to follow an independent course, or to enforce an independent remedy, for the realization of their rights. This the petitioners were attempting to do, in direct contravention of the spirit, the purpose and the express provisions of the amendment.

The district judge found, as a fact, that a sale of the pledged securities by the pledgees would not only impede and obstruct a reorganization of the trust estate, but would prevent the formulation and consummation of a plan of reorganization, and that, for this reason, the petitioners should be enjoined from taking such step, until the further order of the court. The court had the power, under the amendment, to issue the injunction, and the circumstances fully warranted it.

II.

The points made by petitioners.

Viewing Section 77 in the foregoing light, it is clear that the greater part of the points and arguments submitted by the petitioners herein becomes irrelevant.

All the points made and authorities cited as to the power of the district courts under the old bankruptcy proceedings or in equity receiverships to enjoin the sale of securities pledged by a bankrupt, or by a corporation undergoing reorganization, are moot, because Section 77 of the new procedure has completely changed the status of such pledged securities.

This applies also to the objections made by the Reconstruction Finance Corporation (Brief, p. 22) to the sufficiency of the original petition. From the standpoint of Section 77, properly construed, the petition was entirely adequate and sufficient. It showed the court that the Reconstruction Finance Corporation was a secured creditor for the amount of $13,659,877.58, evidenced by six promissory notes, secured by the pledge of listed collateral (meaning collateral listed on the New York Stock Exchange) of the face value of $20,811,500, and of unlisted collateral consisting of First Mortgage Bonds of subsidiary companies of the debtor's system of the face value of $19,490,965.85, all of such unlisted collateral being owned by the debtor (R. 37-38); and secured further by the assignment of the debtor's distributive share in the assets of the Railroad Credit Corporation amounting to approximately $1,400,000. Exhibits A and B to the petition consisted of copies of the form of note to the Reconstruction Finance Corporation

and of a separate agreement with the Corporation and the various banks (R. 44-48). Petition No. 15, paragraph 8 (R. 106), shows that at the time of the filing of the petition, the Debtor was not earning interest on its funded debt. The notes to the Reconstruction Finance Corporation all contained the power to sell the collateral without notice in the event of non-payment of interest. The possibility of sale of the collateral without notice and the consequent anticipation of the action of the Interstate Commerce Commission under any plan that might be proposed, constituted sufficient ground for the court's action in issuing the injunction to preserve the status of these secured debts.

We now pass to a consideration of the other points made by petitioners.

i.

Sections 67(d) and 57(h) of the old bankruptcy act are not applicable.

Petitioners contend that the injunction violates rights preserved to them by certain sections of the old bankruptcy act. The first one we consider is Section 67(d) (U. S. C. A., Title 11, Sec. 107(d)), which reads:

> "Liens given or accepted in good faith and not in contemplation of or in fraud upon the provisions of this title, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by anything herein."

We observe, first, that the injunction now before the Court does not in any degree affect the petitioners' liens

on the pledged securities. Those liens are unimpaired. All that the injunction does is to require the holders to refrain from enforcing their liens through sale or conversion of the collateral, and to hold the collateral *in statu quo* until the further order of the court. The pledgees still constitute secured creditors, and will come into the reorganization plan as secured creditors; and in the formation of the plan their rights as secured creditors must be recognized. This, indeed, is our basic contention,—that Section 77 requires that the rights of creditors, secured and unsecured, shall be dealt with in a reorganization plan, and not otherwise. Section 67(d), therefore, presents no obstacle whatever to the exercise by the court of the power which it exercised in issuing this injunction.

But even if Section 67(d) should be construed as preserving not only the lien, but also the lienor's remedy of private sale, then the logical answer is that Section 67(d) is not effective in these proceedings, because it is not consistent with the provision of Section 77.

Section 77(n) reads as follows:

> "In proceedings under this section *and consistent with the provisions thereof,* the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

This section is relied upon by the petitioners (R. F. C. brief, p. 32, and Banks' brief, p. 36) as ground for the assertion that their rights are still governed by Sections

67(d) and 57(h); but petitioners place the emphasis in the wrong place. The important part of Section 77(n), in this connection, is the words "consistent with the provisions thereof."

It cannot be consistent with the provisions of Section 77, the procedure under which culminates in a reorganization plan, to permit lien holders to sell collateral consisting of the property of the trust estate, thereby anticipating such modifications or alterations of their rights as may be required by the Commission, and approved by the Court, as a part of the plan.

Section 57(h) of the Bankruptcy Act (U. S. C. A., Title 11, Sec. 93(h)) reads as follows:

> "The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance."

The banks in their brief (p. 22) rely on the foregoing language as a justification for their claim of a right to sell the collateral; but a reference to certain portions of Section 77 will negative this idea.

We call the attention of the Court to the first part of paragraph (b) of Section 77:

> "(b) A plan of reorganization within the meaning of this section (1) shall include a proposal to modify or alter the rights of creditors generally, or of any class of them, *secured or unsecured*, either

> through the issuance of new securities of any character or otherwise; (2) may include, in addition, provisions modifying or altering the rights of stockholders generally, or of any class of them; . . ."

There is no room for mistake in the interpretation of this language. The statute, in plain terms, provides that the plan of reorganization *shall* include a proposal to modify or alter the rights of secured creditors. The word "shall" was inserted deliberately. This appears from our comparison above, page 15 (76 Cong. Rec., p. 2905).

We next refer to Section 77(e), which reads in part:

> "(e) A plan of reorganization shall not be finally approved by the commission until it has been accepted in writing and such acceptance has been filed in the proceeding by or on behalf of creditors holding two-thirds in amount of the claims *of each class* whose claims or interest would be affected by the plan, . . ."

And to clause (7) of Section 77(h), which provides that upon confirmation the provisions of the plan shall be binding upon

> "(7) all *secured creditors* of each class of which two-thirds in amount shall have accepted the plan."

With these provisions in mind, we now turn to Section 77(g):

> "(g) Upon such approval by the commission, and after hearing such objections as may be made to the approved plan, the judge shall confirm the plan if satisfied that . . .
>
> "(6) the plan provides with respect to any class of creditors the acceptance of which is requisite to

> the confirmation of the plan, and who would not become bound by the plan under the provisions of subdivision (h) of this section, adequate protection for the realization by them of the value of their securities, liens and claims, either (a) by the sale of such property subject to their liens, if any, or (b) by the sale free of such liens at not less than a fair upset price, and the transfer of such liens to the proceeds of such sale, or (c) by *appraisal* and payment in cash of either the value of such liens and claims or, at the objecting creditors' election, *the value of the securities allotted to such liens* and claims under the plan. Section 57, clause (h), of this Act shall be applicable to the *appraisal* of securities under this section, and the value of the unpaid balance shall be *appraised* as an unsecured claim; . . ."

This makes it clear that the plan must protect a *class of secured creditors* either under subdivision (a) or subdivision (b), above quoted, or under subdivision (c):

> "by appraisal and payment in cash of either the *value* of such liens and claims or, at the objecting creditors' election, the value of the securities *allotted to such liens and claims under the plan.*"

The above reference to Section 57(h) makes it "applicable" only to the *appraisal* of securities; not to their sale or conversion into cash. Further, it is made applicable only to the appraisal of the securities "allotted to such liens and claims under the plan." There could be no clearer indication that the securities now pledged under petitioners' loans must be dealt with in the plan, and, if Section 57(h) has any application, it is only in connection with the appraisal of the securities which may be allotted under the plan to the petitioners as "secured creditors."

In view of these specific provisions of Section 77, how can it be said that Section 67(d), so far as it involves a right to sell the collateral in satisfaction of a lien or Section 57(h), so far as it authorizes the court to dispose of the collateral, is consistent with Section 77? The two are fundamentally opposed, and the only logical construction is that Section 77 has stayed the right of the secured creditor to enforce his lien until it can be done as part of a reorganization plan.* For these secured creditors to at-

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* Section 77(b), above quoted, together with a substantially identical provision in Section 77B, and a somewhat similar provision in Section 74, relating to compositions and extension agreements of individual bankrupts, constitute the first instance where Congress has subjected secured creditors to the bankruptcy power. See Gerdes, *Constitutionality of Section 77B of the Bankruptcy Act*, 1934, XII New York University Law Quarterly Review, 196, at page 205. While the article refers to Section 77B, the language is so apposite to the practically identical provisions of Section 77(b), that we take the liberty of quoting:

> "The central purpose of a proceeding under Section 77B is the reorganization of a corporate debtor in accordance with a plan which, through the issuance of new securities or in other ways, may alter the rights of creditors of any class, secured or unsecured, and of stockholders of any class. For the first time in the history of federal legislation, secured debts are subjected to the bankruptcy power and the secured creditor is faced with the possibility that he may be compelled to submit to an alteration of the rights which he acquired by his contract.
>
> Control over unsecured debts has long been established. A composition which materially modifies the claims of unsecured creditors may be imposed upon a dissenting minority.
>
> There is no difference in principle between a creditor who is secured and one who is unsecured. Both have claims which they are entitled to have satisfied in full out of the debtor's estate. The form of the claim and the method of satisfaction differ, but the difference is one of degree rather than of substance. Fundamentally, the rights are the same. If insolvency or inability to meet debts justifies legislative interference with the one, the same condition will justify similar interference with the other.

tempt to enforce any rights against the pledged collateral is a direct invasion of the province of the Interstate Commerce Commission, to which body was exclusively committed the duty of passing upon a plan and certifying it to the court. Pending the consideration of a plan, the status of each class of creditors, secured and unsecured, must be preserved. Section 77 so commands. It would be a futile statute if the courts of the United States lacked the power to insure that this be done.

In *In re Burgh*, 7 Fed. Supp. 184, at 185 (N. D. Ill., 1933), the Court had before it the provision of Section 74 of the Act, which affects the rights of certain secured creditors in composition proceedings under that section. The Court said:

> "The general purpose of section 74 (11 U. S. C. A., Sec. 202) is, generally speaking, broader in one respect than the general purpose of the Bank-

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The subject of bankruptcies comprehends every phase of 'the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his or their relief.' No definition has ever attempted to limit it to creditors whose claims are unsecured.

A claim is none the less a debt because it is fortified by security, and the holder of such a claim is none the less a creditor. When the requisite financial stringency develops, both the one from whom and the one to whom the claim is due properly come within the subject of bankruptcies. The problem of achieving an equitable adjustment among the secured creditors of an embarrassed debtor and a fair distribution of his shrunken assets among them is essentially the same as in the case of his unsecured creditors. The need for protection is identical.

Congress, possessing a power which 'must, indeed, be held to be general, unlimited and unrestricted over the subject,' may provide the necessary procedure. The fact that hitherto Congress has seen fit to leave this phase to the debtor-creditor relationship untouched does not mean that it can not bring it under control. Its failure to act was a matter of policy and not the measure of its ultimate power."

> ruptcy Act of 1898, and that is the purpose whereby it is proposed that the secured debts of the bankrupt, or debtor, may be affected by the act. The court is unable to discover any good reason why the extension of the benefits of the Bankruptcy Act to secured debts of the bankrupt or debtor should render the act, so extending the benefits, unconstitutional. Generally speaking, bankruptcy acts have always discharged unsecured debts. It is now proposed to compromise or extend secured debts. A secured debt or lien is, so far as the Constitution of the United States is concerned, a no more sacred kind of property than an unsecured debt. In other words, an unsecured debt and a lien are both property, viewed from the standpoint of the Constitution, and the Constitution expressly permits and grants to Congress the exercise of the power to affect such property, whether it be an unsecured debt or whether it be a lien, by laws relating to the 'subject of Bankruptcies.'"

This reasoning is entirely sound, and might clearly have been applied to Section 77(b). If the contention of petitioners is correct, the express mandate of the section, that secured creditor shall be dealt with in the plan, is absolutely destroyed.

The inclusion of secured creditors in Section 74, which was under consideration by Judge Barnes in the above case, was not inadvertent. The matter was discussed in Congress. Mr. Michener, of Michigan, said (76 Cong. Rec., p. 2928):

> "There are those among us who doubt the power of the court, under the Constitution, to take away from the secured creditor his right to enforce his lien in accordance with the stipulated contract. Of

course, under this proposal the lien is not destroyed, but in many cases the only value of the lien is the right vested in the secured creditor to enforce the lien according to the terms of the contract. A delay may possibly, and in many cases will, impair the contract which the parties have solemnly entered into.

I realize that the courts have already gone a long way in permitting the Federal court to take jurisdiction over all of the property of the debtor, even to delaying the enforcement of liens in forums other than the bankruptcy court having jurisdiction, but it must be remembered that in those cases which have been cited to-day the court acted upon the principle that it was engaged in the orderly liquidation of the debtor's property, with the right to enforce the rights of the secured creditors. The very purpose of the contemplated procedure is to avoid liquidation, and it is at least very doubtful, if the court will ever go so far, under the bankruptcy clause of the Constitution, as to hold at bay indefinitely the right of a secured creditor to take advantage of his contract, in the presumption that the debtor might, if given an extension, some way, somehow, at some time in the future, be able to make the lien as valuable to the creditor as it was when the extension was granted. This is substituting the guess of the court for the written agreement of the parties. I realize that there is a distinction between destroying a lien and modifying the procedure by which a lien is made effective."

Nevertheless, Section 74 became a law and the quoted provisions in Section 77 likewise became a law.

ii.

Section 77(l) does not sanction sale of the pledged collateral.

Section 77(l) reads as follows:

> "In addition to the provisions of Section 11 of this Act for the staying of pending suits against the debtor, such suits shall be further stayed until after final decree (and)* the judge may, upon notice and for cause shown, enjoin or stay the commencement or continuance of *any judicial proceeding to enforce any lien upon the estate until after final decree.*"

The petitioners contend that, by familiar rules of statutory construction, the failure of this subsection specifically to include the authority to stay the sale of collateral otherwise than in judicial proceedings, indicates an intention that the court should have no such power (Banks' brief, p. 37; R. F. C. brief, p. 48).

Power to do what the Court has done in this case is found in the comprehensive language of Section 2(15) of the Bankruptcy Act, which authorizes the Court to

> "make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title."

Section 77(l) sheds an interesting light, however, on the practical necessity for the injunction. There can be no doubt that this section authorizes the court to stay the enforcement of the mortgage bonds themselves, and the

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* The word "and" seems inadvertently to have been omitted from the statute.

Court has stayed such enforcement (Order approving petition, par. 8, R. 9). No bondholder or trustee of the mortgage can enforce a lien on the trust estate pending reorganization. The First and Refunding Mortgage Trustees may not proceed to enforce their lien on the physical properties of the trust estate, although the principal amount of the bonds, of which $163,000,000 are outstanding, fell due April 1, 1934 (R. 65). Under the orders of the Court made pursuant to paragraph (l), all the proceedings to enforce the lien of the mortgage are stayed. Yet, if petitioners' view of paragraph (l) is correct, the Trustees of the First and Refunding Mortgage may forthwith sell and dispose of the $66,000,000 of bonds and $30,000,000 of capital stock of subsidiary corporations (R. 66, par. 4(a)) all pledged as collateral thereunder.

Likewise petitioners, as pledgees of $54,000,000 face amount of bonds, secured by a lien on various portions of the trust estate, may increase the obligations of the trust estate to the extent of approximately $37,000,000 by selling these bonds.

As a practical matter, this demonstrates that the failure of Section 77(l) specifically to include the power to restrain pledgees from selling their collateral privately did not manifest an intention on the part of Congress that they should have any such right, but merely that Congress considered that the courts have power, under Section 2(15) of the Act, to restrain such private sale, if it should become necessary.

iii.

Territorial jurisdiction.

In our view of proceedings under Section 77, the question of territorial jurisdiction of the District Court, which is argued at length by the non-resident banks (Banks' brief, p. 79), is disposed of by the very nature of the proceedings.

One of the first difficulties dealt with in putting the reorganization statute into the Bankruptcy Act was the matter of ancillary proceedings.

Most railroad systems operate in many states. The Rock Island, principal debtor in this case, extends into fourteen. Congress met this problem by authorizing all the subsidiary companies of the principal debtor to come into the same proceedings, and to effect a plan of reorganization in connection with, or as a part of, the principal plan; and provided that, having been admitted,

> "thereupon such court shall have the same jurisdiction with respect to it (referring to the subsidiary corporation) its property, its creditors and stockholders, as the court has with respect to such other debtor." (Sec. 77(a))

This provision necessarily extended the territorial jurisdiction of the District Court in which the principal proceedings were pending. It was for this reason that the first part of Section 77(a) provides:

> "the court in which such order approving the petition is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located."

As a practical matter, the District Court for the Northern District of Illinois, in which these proceedings were instituted, is now, through its Trustees, operating a railroad system of 8,300 miles, with lines in fourteen states (Order No. 10, R. 26; Order No. 25, R. 97). None of these subsidiary debtors has a line of railway within the Northern District of Illinois. The Court under the aegis of this Act has reached out its hands to thirteen states, and daily and hourly, through its Trustees, is engaged in operating a large railway system in those states, as well as in the Northern District of Illinois.

Being so engaged, it may protect that property, wherever located. The injunction order of the court may run to any point where there may be property.

> "In bankruptcy, this rule applies regardless of whether the property is located in the district in which the bankruptcy proceeding originated. The *injunction* to protect its possession may issue either *from the court of original jurisdiction,* or from the federal court for the district in which the state court suit is brought or in which the plaintiff in that suit resides. *Isaacs* v. *Hobbs Tie and Timber Company,* 282 U. S. 734, 737-8."
>
> *Ex parte* Baldwin and Thompson, Trustees, *et al.*, 291 U. S. 610, 54 Sup. Ct. Rep. 551 (1934).

The case cited involved a petition by trustees in bankruptcy, appointed by the District Court for the Eastern District of Missouri, in a proceeding therein pending under Section 77, to remove a case brought in a state court of Texas to the United States District Court for the Southern District of Texas. The plaintiffs in the state court sought to forfeit title to a part of the right of way comprised in the

trustees' estate, said right of way being located in the State of Texas, and to enjoin the trustees from making further use of the lands for the operation of the railway. In dismissing the petition for mandamus to compel the U. S. District Court to take jurisdiction, the Supreme Court further said:

> "We are of opinion that the trustees may be entitled to have their controversy with the investment company adjudicated in the federal court, but are not entitled to the remedy of mandamus, because, to secure adjudication in the federal court of their rights and duties, they could have applied, and still can apply so far as now appears, *either in the original bankruptcy proceeding*, or by an ancillary bill in Texas, for an injunction to restrain the investment company from prosecuting its suit in the state court."

And again:

> "It is sufficient that the extraordinary remedy of mandamus should be denied, because the Trustees may by the common remedy of injunction prevent any interference with the jurisdiction of the bankruptcy court. Compare *Ex parte Park Square Automobile Station*, 244 U. S. 412, 414; *Ex parte Riddle*, 255 U. S. 450; *Ex parte Kreutler-Arnold Hinge Last Co.*, 286 U. S. 533."

The test of the Court's power does not depend upon the possession of the property. Any injunction operates *in personam*. The injunction which the Trustees in the *Baldwin* case might have secured from the District Court for the Eastern District of Missouri would have acted *in personam* against the Investment Company in Texas. The

fortuitous circumstance that in that case the property was actually in the physical possession of the Trustees did not enlarge the Court's power. The Trustees in this proceeding have title to all the property that belongs to the trust estate, including the interest of the debtor in these pledged securities. Having such title, the Court has power to protect it in any necessary way, including an injunction against any person in possession of such property who might, unless enjoined, alter its status to the detriment of the reorganization proceeding.

iv.

The Injunction Was Justified by the Facts.

This is discussed by the banks in their brief, at page 49, and again at page 74; and in the Reconstruction Finance Corporation brief, page 89. The banks point out (Brief, p. 12) that the market value of the collateral securing their loans has declined since the injunction was issued from $4,153,355 to $2,389,980.

This decline in market value, of course, has affected all the other securities of the trust estate, both those of the principal debtor and those of the subsidiary corporations. It is not caused by the injunction, but by the continuance of the depression. It is the same situation which up to this time has prevented a reorganization, and prevented the Reconstruction Finance Corporation from being able to suggest a feasible plan of reorganization when the Trustees called all the creditors together and asked them for their suggestions (Appendix to R. F. C. Brief, pp. 170, 172).

But the continuance of the depression has accentuated the necessity for the injunction. Whether the market value of the pledged securities is greater or less than the amount of the loans for which they are pledged, the necessity for the injunction exists in either case; indeed, it might be said that the necessity for the injunction is greater in the latter case.

An apt illustration of the effect of a possible sale of the collateral is afforded by a reference to the $40,000,000 Secured 4½% Gold Bonds Series A due September 1, 1952, of the principal debtor, which are secured by a pledge as collateral of $45,000,000 First and Refunding Gold Bonds of the principal debtor (Petition No. 11, R. 28: par. 2, R. 30). The current market quotation of these First and Refunding 4% Gold Bonds is approximately 16, or a total market value for the $45,000,000 collateral of $7,200,000. If the Trustee of the Indenture securing the Secured 4½% Gold Bonds should be permitted to sell the $45,000,000 collateral, at the present prices, it would realize thereon the sum of $7,200,000, which it would thereupon credit upon the face of the debt now standing at $40,000,000, plus interest since September 1, 1933. If it applied the proceeds entirely against the principal of the debt, it would have a deficiency claim against the trust estate for $32,800,000. In addition, the purchasers of the $45,000,000 Refunding Bonds could insist that their bonds be dealt with in the reorganization plan; so that, instead of a claim against the trust estate for $40,000,000 and interest, there would be a deficiency claim of $32,800,000 by the Trustees of the Indenture, and claims by the bondholders aggregating $45,000,000, or a total of $77,800,000, an increase of $37,800,000 in the claims against the trust estate resulting

from the mere fact of the sale of the collateral securing this one series of Debentures. From a practical standpoint, no better illustration can be offered of the effect on the trust estate of permitting secured creditors to dispose of their collateral.

Or take the banks' own case, as set out in their brief. On page 7 of the banks' brief, it is shown that for obligations now standing at $3,866,923.34 the banks hold collateral of a face value of $14,409,000. On page 12, it is shown that the market value of this collateral as of January 12, 1935, was $2,389,980, or about $1,500,000 below the amount of the banks' claim. If now the banks are permitted to sell their collateral, they may prove a claim for the deficiency of $1,500,000, which must be taken care of in the reorganization plan; and, in addition, the purchasers of the collateral may prove secured claims based thereon aggregating $14,409,000; an increase of $12,043,000 in the claims against the trust estate. The same is true of the Reconstruction Finance Corporation loans. For loans aggregating some $13,000,000, the Reconstruction Finance Corporation has collateral of a face value of about $40,000,000 or more; consisting of bonds of the principal debtor, of several of the subsidiary debtors, and First Mortgage Bonds of subsidiary companies, all constituting first liens on terminal or other properties used in the operation of the trust estate (R. 38). The unlisted collateral has no quoted market value, but the principle is the same. No matter on what basis it was sold, if it should be sold, the result would be a large increase in the provable claims against the trust estate.

The Reconstruction Finance Corporation brief states (p. 97):

> "The Court will, we believe, take judicial notice of the fact that a railroad reorganization is essentially a bargaining process between creditors and security holders. The result turns largely on the position of the respective parties. A mortgagee able to foreclose has one position. A mortgagee unable to foreclose has another. A note holder, separated by injunction from mortgage collateral, has almost no bargaining power at all, and may be dealt with lightly in the timing of the reorganization or in ultimate distribution of new securities. These considerations are particularly compelling in the case at bar. Here the short-term debt is so large that it is hardly conceivable that the short-term debt can be paid off in cash on reorganization."

This line of reasoning ignores entirely the function to be played by the Interstate Commerce Commission in the consideration of a plan of reorganization. It certainly does not afford any ground for overthrowing the injunction.

V.

Sundry Objections.

1. *The Fifth Amendment.*

We do not consume the Court's time with a discussion of the Fifth Amendment. The quotation above (p. 12) from *Nebbia* v. *New York* is a complete answer to the contentions of petitioners. The reports are full of cases where contract rights have been interfered with by legislation under the bankruptcy power, the power to regulate commerce, and every other power that is conferred upon Congress.

2. *Considerations of economic policy.*

The Reconstruction Finance Corporation devotes quite a chapter to this subject. (Brief, p. 70). This matter, however, is not for the court. As the court has said many times, the question of policy is for the legislature. It may be presumed that the Interstate Commerce Commission, in passing upon a reorganization plan, is equipped to and will give such consideration to the economic policy involved as the circumstances may require.

3. *Voting in two classes.*

The Reconstruction Finance Corporation (Brief, p. 91) says that since the pledged bonds must be treated as outstanding for the purposes of the approval of the plan, a sale of the pledged bonds would not amount to a shifting of the classes of creditors in such a way as to affect the plan. The Reconstruction Finance Corporation, at page 91 of its brief, states:

> A. *Under Section 77, the pledged bonds must be treated as outstanding for the purposes of the approval of the plan, and hence there can be no such shifting of classes of creditors or such changes in the size of the various classes of creditors as will prevent the preparation and effectuation of a plan.*

Since it is easily demonstrable that a sale of the collateral would affect a change "in the size of the various classes of creditors," as represented by the amounts of their claims, by increasing the obligations of the trust estate in the sum of approximately $200,000,000, the effect of such a shifting upon the preparation of a reorganization plan is obvious; but the suggestion that the holder of pledged collateral is entitled to vote upon the plan, first,

as the holder of a secured note, and, second, in each class of creditors of which he happens to hold the securities as collateral, is novel. It will be met, of course, when the time for voting arrives, but, if it is permitted, it will be the first time in any bankruptcy proceeding that a creditor is allowed to vote twice, first, on his claim, and then on his collateral.

4. *Section 5 of the Reconstruction Finance Corporation Act.*

This is the section which authorizes the Reconstruction Finance Corporation to liquidate collateral accepted by it as security for loans. The Reconstruction Finance Corporation contends that, by reason of this section, the court is powerless in a proceeding under Section 77 to restrain such liquidation (R. F. C. Brief, p. 65).

Section 5 is simply a grant of charter power, similar to that granted to national banking associations by the National Banking Act (U. S. C. A., Title 12, Sec. 24). But this charter power to liquidate pledged securities must be exercised according to law, including the law contained in Section 77.

Respectfully submitted,

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(NOTE: Italics supplied throughout.)